DOCUMENT RESUME

ED 480 909 HE 036 141

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TITLE	Taxpayer Information: Increased Sharing and Verifying of Information Could Improve Education's Award Decisions. Report to the Committee on Finance, U.S. Senate.
INSTITUTION	General Accounting Office, Washington, DC.
REPORT NO	GAO-03-821
PUB DATE	2003-07-00
NOTE	29p.
AVAILABLE FROM	U.S. General Accounting Office, 441 G Street NW, Room LM, Washington, DC 20548 (first copy free; additional copies, $2 each). Tel: 202-512-6000. For full text: http://www.gao.gov/cgi-bin/getrpt?GAO-03-821.
PUB TYPE	Reports - Evaluative (142)
EDRS PRICE	EDRS Price MF01/PC02 Plus Postage.
DESCRIPTORS	*Agency Cooperation; *Eligibility; *Financial Aid Applicants; Higher Education; *Information Dissemination; *Student Financial Aid; *Taxes
IDENTIFIERS	*Department of Education; *Internal Revenue Service; Taxpayer Equity

ABSTRACT

The U.S. General Accounting Office (GAO) was asked to determine whether the U.S. Department of Education uses taxpayer information to verify information provided by student aid applicants, and the benefits of increasing data verification activities, and whether the Internal Revenue Service (IRS) uses personal information maintained by Education to ensure that taxpayers meet their tax obligations and the benefits of increasing these activities. From various sources, the GAO found that the Department of Education uses taxpayer information for several purposes, such as locating loan defaulters, researching and computing statistical data on overall borrower debt, and, in taxpayers' consent, determining loan repayment amounts. However, Education is not authorized to receive taxpayer information from the IRS to verify eligibility for student financial aid provided under Title IV of the Higher Education Act of 1965. The IRS does not use personal information collected from applicants and maintained by Education to ensure that taxpayers meet their tax obligations because IRS believes the taxpayer information IRS receives is more accurate. In general, this view is supported by past estimates of taxpayers' levels of compliance and information from Education's studies and investigations. In this report, GAO does not make any recommendations; however, earlier in 2003, GAO recommended that Congress consider legislation to authorize IRS to release individual income data to Education, a change the Department of Education would support. Three appendixes describe study methodology and present commentary from Education and the IRS. (SLD)

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United States General Accounting Office

GAO

Report to the Committee on Finance, U.S. Senate

July 2003

TAXPAYER INFORMATION

Increased Sharing and Verifying of Information Could Improve Education's Award Decisions

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Highlights

Highlights of GAO-03-821, a report to the Committee on Finance, U.S. Senate

TAXPAYER INFORMATION

Increased Sharing and Verifying of Information Could Improve Education's Award Decisions

Why GAO Did This Study

Data sharing can be a valuable tool for federal agencies in determining applicants' eligibility for benefit and loan programs. Congress has authorized the Department of Education, among others, to have limited access to federal taxpayer information collected by the Internal Revenue Service (IRS). Likewise, IRS is able to use personal information collected by outside sources to better ensure that taxpayers are meeting their tax obligations.

GAO was asked to determine whether Education uses taxpayer information to verify information provided by student aid applicants, and the benefits of increasing data verification activities, and whether IRS uses personal information maintained by Education to ensure that taxpayers meet their tax obligations, and the benefits of increasing these activities.

What GAO Recommends

GAO is not making any recommendations. However, earlier this year GAO recommended that Congress consider legislation to authorize IRS to release individual income data to Education so that Education could verify income on student aid applications. The IRS Commissioner and Education's Chief Operating Officer of Federal Student Aid raised no concerns in commenting on a draft of this report. The Chief Operating Officer said Education would continue to support a legislative change.

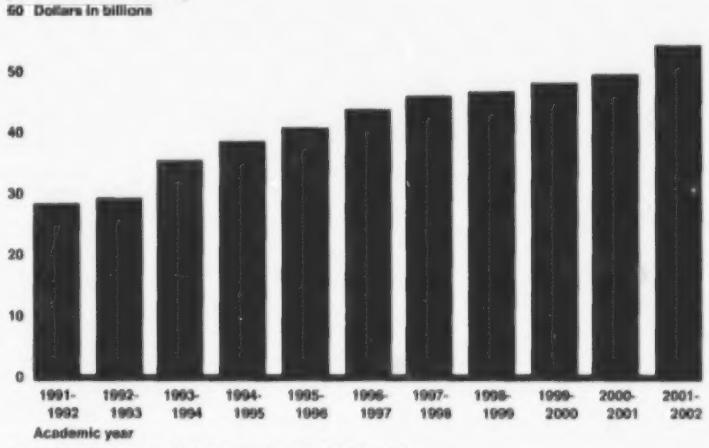
www.gao.gov/cgi-bin/getrpt?GAO-03-821.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9039 or brostekm@gao.gov.

What GAO Found

Education uses taxpayer information for several purposes, such as locating loan defaulters; researching and computing statistical data on overall borrower debt; and, upon taxpayers' consent, determining loan repayment amounts. However, Education is not authorized to directly receive taxpayer information from IRS to verify eligibility for student financial aid provided under Title IV of the Higher Education Act of 1965 (HEA). In academic year 2001-02, 11.4 million students applied for $54 billion in aid.

Total Title IV Federal Student Aid Dollars from Academic Years 1991-92 to 2001-02 (in Constant Dollars)



Source: The College Board, *Trends in Student Aid 2002*, Washington, D.C.

A 1998 amendment to HEA was intended to authorize the matching of student aid applicant information with several elements of federal income tax return information. However, HEA could not be used as intended because Internal Revenue Code Section 6103 was not specifically amended so that Education and its contractors, which assist Education in administering the various financial aid programs, could have access to taxpayer information. Based on a study that matched Education data and IRS income information, Education estimates that it made approximately $602 million in grant overpayments during fiscal years 2001 and 2002.

IRS does not use personal information collected from applicants and maintained by Education to ensure that taxpayers meet their tax obligations because IRS officials believe the taxpayer information IRS receives is more accurate. In general, IRS officials' views are supported by IRS's past estimates of taxpayers' levels of compliance and by the results of Education's studies and investigations. For example, in the mid-1990s, IRS estimated that taxpayers with only wage income had a 99 percent voluntary compliance rate and taxpayers with interest and dividend income were 95 percent compliant in reporting this income. However, Education's student aid application data are not suited to IRS's tax administration purposes because the applications ask students and/or their parents to report data that come directly from their tax returns.

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United States General Accounting Office
Washington, DC 20548

July 18, 2003

The Honorable Charles E. Grassley
Chairman
The Honorable Max Baucus
Ranking Minority Member
Committee on Finance
United States Senate

Each year, federal agencies make billions of dollars of improper payments under various federal programs. Over the years, Congress has authorized a number of federal agencies to have access to federal taxpayer information[1] collected by the Internal Revenue Service (IRS) to improve the accuracy of eligibility determinations made by those agencies. The authorized agencies are able to verify (i.e., match or cross-check) some personal information[2] provided by applicants against corresponding information reported to IRS.

Similarly, IRS is able to use some of the personal information obtained from federal and state agencies to better ensure that taxpayers are meeting their tax obligations. Various federal laws and agency policies regulate agencies' use and disclosure of taxpayer and personal information. Section 6103 of the Internal Revenue Code (IRC) allows IRS to disclose taxpayer information to federal agencies and authorized employees of those agencies, but only under specific conditions. Such privacy protection is an important component of continued voluntary compliance with the internal revenue laws.

Because of continued concerns about balancing taxpayer privacy interests with potential increased benefits from the sharing of taxpayer information among agencies administering federal benefit and loan programs, you asked us to assess whether IRS and selected federal agencies—the Bureau

[1]Taxpayer information includes all federal tax returns and return information. This may consist of an individual's name, Social Security number, address, wages, self-reported earnings, unearned income from interest and dividends, tax returns, and miscellaneous income statements.

[2]Personal information is defined as all information associated with an individual and includes both identifying information (e.g., name, Social Security number, and E-mail address) and nonidentifying information (e.g., financial information, education, age, gender, and physical attributes).

of Citizenship and Immigration Services (formerly the Immigration and Naturalization Service), the Social Security Administration, and the Department of Education—are making use of opportunities to use taxpayer information and personal applicant information to improve eligibility determinations and tax administration.

During the course of this work, you asked us to report separately on the data sharing and verifying activities between IRS and Education and provide information that can be used as Congress considers legislative changes to IRC Section 6103. As agreed with your offices, our objectives were to determine whether (1) Education uses IRS taxpayer information to verify information provided by applicants for federal student financial aid and the benefits, if any, of increasing verification activities and (2) IRS uses personal information maintained by Education to ensure that taxpayers meet their tax obligations and the benefits, if any, of increasing these activities.

To respond to your request, we performed our work at various IRS offices, including compliance and research offices, and various program offices at Education. As used in this report, "data sharing" means obtaining and disclosing information on individuals between Education and IRS to determine eligibility for student financial aid and to ensure that taxpayers have met their obligations. We collected and analyzed information on data sharing and verifying activities between IRS and Education, including the type of information received and how the information is used. We reviewed federal laws and agency guidance regarding the collection, disclosure, and use of taxpayer and other personal information. We also interviewed IRS and Education officials to obtain views on possible impediments or missed opportunities to share and verify taxpayer and other personal information, as well as the potential benefits of increasing these activities. We conducted our work from August 2002 through June 2003 in accordance with generally accepted government auditing standards. For details on our scope and methodology, see appendix I.

Results in Brief

Education is not authorized to directly receive taxpayer information from IRS to verify eligibility for its student financial aid programs, for which Education estimates it made hundreds of millions in Pell Grant overpayments in fiscal years 2001 and 2002. Education uses taxpayer information for several purposes, such as locating loan defaulters; researching and computing statistical data on overall borrower debt; and, upon taxpayers' consent, determining loan repayment amounts. However, Education is not authorized to directly receive taxpayer information from

IRS to verify eligibility for student financial aid provided under Title IV of the Higher Education Act of 1965 (HEA).

In 1998, HEA was amended to allow increased data sharing. However, the provision could not be used as intended because IRC Section 6103 was not specifically amended so that Education and its contractors could have access to taxpayer information. In academic year 2001-02, 11.4 million students applied for $54 billion in aid under these programs. Education demonstrated the benefits of using taxpayer information to verify the personal information that is used to determine student aid applicants' need for assistance. Based on a study that matched Education data and IRS income information, Education estimates that it made approximately $602 million in Pell Grant overpayments during fiscal years 2001 and 2002.

IRS does not use personal information collected from applicants and maintained by Education to ensure that taxpayers meet their tax obligations because IRS officials believe the taxpayer information they already receive is more accurate. In general, IRS officials' views are supported by IRS's own data and by the results of Education studies and investigations. For example, in the mid-1990s, IRS estimated that taxpayers with only wage income had a 99 percent voluntary compliance rate and taxpayers with interest and dividend income were 95 percent compliant in reporting this income. Taxpayers with certain other sources of income are much less compliant. However, Education's student aid application data are not suited to aiding IRS's efforts because the applications ask students and/or their parents to report data that come directly from their tax returns.

We are not making any recommendations. However, in September 2000 we recommended that Congress consider amending IRC Section 6103 to authorize IRS to disclose certain taxpayer information to Education for the purpose of verifying information reported on federal student aid applications. Earlier this year, we also reported that Education could benefit from receiving taxpayer information for this purpose.

On July 15, 2003, the Commissioner of Internal Revenue and the Chief Operating Officer of Education's Office of Federal Student Aid raised no concerns in responding to a draft of this report. (See the Agency Comments and Our Evaluation section and apps. II and III.) Officials representing the Office of Federal Student Aid provided technical comments, which we have incorporated into the report where appropriate.

Background

IRC Section 6103 allows IRS to disclose taxpayer information to federal agencies and to authorized employees of those agencies for specified purposes. It was enacted, in part, to control whether and how tax information submitted to IRS on federal tax returns could be shared. IRC Section 6103 specifies which agencies (or other entities) may have access to certain types of tax return information, for what purposes such access may be granted, and under what conditions the information will be received. For example, before receiving taxpayer information, agencies are required to advise IRS how they intend to use the information and to establish detailed plans that ensure the confidentiality and safeguarding of the information.

Similar to IRC Section 6103, the Privacy Act of 1974 regulates the federal government's use of personal information by limiting the collection, disclosure, and use of personal information maintained in an agency's system of records. Personal information is further protected by the Computer Matching and Privacy Protection Act of 1988 (Privacy Act). It requires that agencies enter into written agreements, referred to as matching agreements, when they share information that is protected by the Privacy Act for the purpose of conducting computer matches.

IRS receives tax returns from about 88 million individual taxpayers who have wage and investment income, and approximately 45 million small business and self-employed taxpayers. IRS performs a variety of checks to ensure the accuracy of information these taxpayers report on their tax returns. These checks include verifying computations on returns, requesting more information about items on tax returns, and matching information reported by third parties to income reported by taxpayers on returns (e.g., document matching). IRS's document matching program has proven to be a highly cost-effective way of identifying underreported income, thereby bringing in billions of dollars of tax revenue while at the same time boosting voluntary compliance.

Approximately 11 million individuals applied for over $50 billion in federal student financial aid in academic year 2001-02. Title IV of HEA authorized several student aid programs, including the following:

- Pell Grants—grants to undergraduate students who are enrolled in degree or certificate programs and have federally defined financial need;

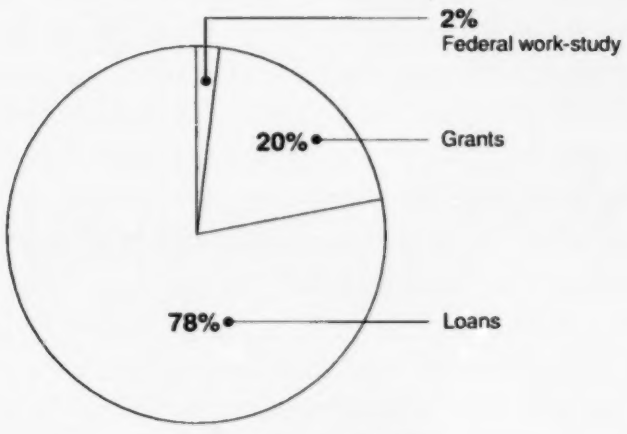
- Supplemental Educational Opportunity Grants (SEOG)—grants for undergraduate students with federally defined financial need;
- Stafford[3] and Parent Loans for Undergraduate Students (PLUS) loans[4]—loans that are made by private lenders and guaranteed by the federal government (guaranteed loans) or made directly by the federal government through a student's school (Direct Loans);
- Perkins loans—low-interest loans to undergraduate and graduate students for which interest does not accrue while the students are enrolled at least half-time in eligible programs; and
- Work-study—on- or off-campus jobs for which students who have federally defined need earn at least the current federal minimum wage and for which institutions or off-campus employers pay a portion of their wages.

As shown in figure 1, for academic year 2001-02, 78 percent of federal student aid came from loans, 20 percent came from grants, and 2 percent came from federal work-study programs.

[3]Stafford loans consist of subsidized and unsubsidized loans. Subsidized loans are loans for which the federal government pays the interest costs while the student is in school. Unsubsidized loans are loans for which the student is responsible for paying all interest costs.

[4]Both graduate and undergraduate students receive Stafford loans while parents of dependent students receive PLUS loans.

Figure 1: Title IV Federal Student Aid by Source for Academic Year 2001-02 (Constant Dollars)



Source: The College Board, *Trends in Student Aid 2002*, Washington, D.C.

Notes: Percentages based on estimated dollar amounts for academic year 2001-02. Percentage of grants includes both Pell Grants and SEOGs. Percentage of loans includes Stafford loans, PLUS loans, and Perkins loans. Current year dollars adjusted for inflation using the Consumer Price Index as calculated by the Bureau of Labor Statistics, U.S. Department of Labor.

Education has created many information systems to support the various student financial aid programs it administers. In many cases, these systems are maintained and operated by contractors, which are responsible for processing the student financial aid application data and providing such data to the schools, as well as to Education to use in managing and overseeing the programs. As such, a student's financial aid process begins when he or she submits the Free Application for Federal Student Aid (FAFSA). The student (and parents of a dependent student) submits the FAFSA to the contractor that enters the data from the application. On behalf of Education, the contractor calculates the expected family contribution figure and performs database matches and edits to ensure that all needed information is included and that the student meets eligibility requirements, including not having defaulted on a prior student loan. The contractor then sends the results of the matches and other processing results to the student and the school(s). The school(s) request any supporting documents needed to verify application data and determine the student's eligibility for aid, and construct an award package of available types of aid. Funds are then disbursed to the school(s) according to the student financial aid program requirements.

Education Could Benefit from Access to Taxpayer Information to Verify Student Eligibility for Financial Aid Programs

Education uses taxpayer information for some eligibility determinations and other purposes, but is not authorized to directly receive taxpayer information from IRS to verify student financial aid eligibility or determine payment amounts for its federal student aid programs—due to IRC Section 6103 restrictions. During fiscal years 2001 and 2002, Education could have benefited from using taxpayer information to verify personal information from student aid applicants. Using aggregate IRS income information, Education estimates that $602 million in grant overpayments occurred during this time.

Education Uses Taxpayer Information for Several Purposes

Education uses the taxpayer information it receives from IRS to determine approximately 100,000 borrowers' monthly loan repayment amounts, to determine the addresses for approximately 4.6 million records of borrowers who may have defaulted on their student loans, and to develop aggregate borrower debt statistics.

In order to determine the monthly repayment amount for borrowers participating in the income contingent repayment (ICR) plan, Education, under IRC Section 6103(l)(13), receives income information on the borrower from IRS. The ICR plan allows Federal Direct Loan Program borrowers to repay loans as a percentage of their income. To participate in this program, the borrower must authorize IRS (i.e., give his or her consent) to share income information with Education.[5] Approximately 100,000 consents are processed under the ICR plan for repayment each year.

Under the Taxpayer Address Request (TAR) program, as authorized by IRC Section 6103(m)(4), IRS provides the mailing addresses of taxpayers to Education to be used in collecting debt from student loan defaulters.[6] Specifically, Education furnishes the name and Social Security number

[5]IRC Section 6103 (l)(13) temporarily permits IRS to disclose the taxpayer's identity information, filing status, and adjusted gross income to Education employees for use in establishing the appropriate ICR amount for an applicable student loan. In practice, disclosures for these purposes are only made with the taxpayer's consent under IRC Section 6103(c) because Education uses contractors to administer its ICR program and 6103(l)(13) prevents disclosure to contractors. The 6103(l)(13) provision has an expiration date of September 30, 2003.

[6]Unlike IRC Section 6103 (l)(13) disclosures, which may only be made to Education employees, IRC Section 6103(m)(4) disclosures can be made to contractors.

(SSN) to the IRS for each defaulted student. IRS then conducts a match of the information and provides Education the most recent address for the taxpayer. Education sends about 4.6 million records annually to IRS for matching under the TAR program.

Additionally, as part of its research activities, Education receives aggregate taxpayer income information from IRS in the form of tables that it uses in establishing performance measures and selection criteria for its student aid application verification process. Education also uses these data in researching and computing statistical data on overall borrower debt, such as determining the average and median debt burden ratios for any given year.

As part of the federal student aid application process, every year since the mid-1980s, Education selects approximately 30 percent of its student aid applicants for verification purposes.[7] When a student is selected for verification, he or she is required to provide copies of his or her (or parents') tax returns to the school.[8] If the student refuses to do so, he or she will not receive federal aid. The school then compares the information on the tax return to information on the FAFSA and corrects any inconsistencies on the FAFSA to match the information on the tax return.[9] This current verification process has at least two drawbacks. The process is time consuming and paper intensive because it involves approximately 3.6 million paper copies of tax returns that schools match. In addition, the process relies on applicants providing copies of their tax returns, which may not be the same as those submitted to IRS.

Beginning in October 2002, Education began an electronic verification pilot project involving 148 of these selected students who were asked to authorize IRS to release their tax information to their academic institutions via the Internet. The purpose of this pilot was to take the student and/or his or her parents out of the middle of the verification

[7]Education determines who falls into that sample based on analyses of past years' data on the characteristics of those individuals who are most likely to commit errors on their applications. Education primarily focuses on selecting students who are eligible for federal grants.

[8]Not all individuals selected for the 30 percent sample are required to provide copies of their tax returns. Some of these individuals are legitimately not required to file tax returns, and instead, provide the school with statements attesting to their nonfiling status and the amount and type of their untaxed income.

[9]Education has established a $400 tolerance level for the discrepancy amount.

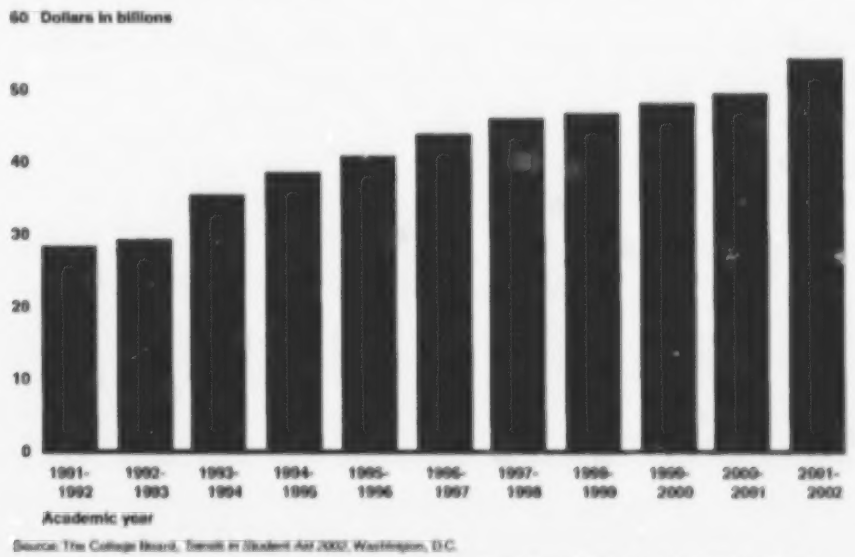
process between the IRS and the school so that the school relies on income information it obtains directly from IRS, thereby making the process more efficient.

Under this pilot project, once the student, parent, or spouse authorized the release of his or her tax information, IRS sent the tax transcripts for that individual to the school, which then resolved any inconsistencies between information on the tax transcript and on the FAFSA. This pilot match ended on March 31, 2003, and, according to an Education official, the initial feedback from the participating schools and taxpayers was very positive. Education officials are currently compiling data from the pilot schools and taxpayers and will be issuing a report in the fall of 2003 on the ease of use, statistical data, and any needed changes.

Legal Impediment Hinders Data Sharing for Education's Student Financial Aid Programs

Although Education receives some taxpayer information in conjunction with some of its programs, IRC Section 6103 does not authorize Education to obtain taxpayer information directly from IRS to verify eligibility or determine payment amounts for its federal student aid programs. Approximately 11.4 million individuals applied for over $50 billion in federal student financial aid in academic year 2001-02. As shown in figure 2, over a 10-year academic period, the amount of student aid awarded grew 92 percent, from approximately $28 billion in academic year 1991-92 to approximately $54 billion in academic year 2001-02.

Figure 2: Total Title IV Federal Student Aid Dollars from Academic Years 1991-92 to 2001-02 (In Constant Dollars)



Source: The College Board, Trends in Student Aid 2002, Washington, D.C.

Note: Percentages based on estimated dollar amounts for academic years 2000-01 and 2001-02.

Also, because IRC Section 6103 does not authorize Education to directly obtain taxpayer information from IRS to establish the repayment amount for ICR student loans, taxpayer consent is required for IRS to share income information with Education.

IRC Section 6103 was enacted, in part, to control whether and how tax information submitted to IRS on federal tax returns could be shared. It was amended in 1976 in an attempt to balance confidentiality and the need to disclose returns and return information for legitimate purposes. Determining the most appropriate way to balance these two considerations has been an issue that has faced Congress for a number of years. Congress believed that not only did taxpayers have a right to expect the personal information they report to IRS to remain private, but that such privacy protection was also an important component of continued voluntary compliance. Moreover, many observers and privacy advocates believe that disclosure of return information may decrease taxpayers' willingness to comply with the tax law and that tax administration suffers when return information is disclosed for nontax purposes.

IRC Section 6103 restrictions were the focus of past legislative action taken to address limitations on data sharing and matching activities between IRS and Education in connection with student financial aid programs. According to Education officials, a 1998 amendment to HEA was intended to authorize the matching of student aid applicant information with several elements of federal income tax return information. However, that provision could not be used as intended because IRC Section 6103 was not specifically amended so that Education and its contractors, which assist Education in administering the various financial aid programs, could have access to taxpayer information.

In an October 2000 report to Congress on taxpayer confidentiality and the use of taxpayer information, Treasury's Office of Tax Policy recommended that IRC Section 6103 be amended to permit disclosure of necessary items to Education for income verification, and to permit the use of contractors as contemplated by HEA, if Education could show that such disclosure was warranted.[9] Further, in August 2002, officials from Treasury, the Office of Management and Budget, and Education proposed a legislative amendment to IRC Section 6103 that would allow IRS to match the income reported on federal student aid applications with income tax return information and share the results with Education.

The language in the proposed amendment stresses balancing the need for accurate student aid applicant information with the importance of maintaining the integrity of IRS taxpayer information. The proposed legislative amendment specifies, "the tax data would be disclosed only for very limited purposes, only to the Department of Education and its contractors, and then only after a series of rigorous safeguards were implemented." The proposed amendment was included in the President's Fiscal Year 2004 Budget, which stated that IRS matching of student aid application income data with applicant tax data "is projected to save $638 million in Pell Grant costs over 2003–2004, significantly reducing existing funding shortfalls."[10] However, it does not appear in the Taxpayer

[9]U.S. Department of the Treasury, Office of Tax Policy, *Report to Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions, Vol. I: Study of General Provisions* (Washington, D.C.: October 2000).

[10]Office of Management and Budget, Executive Office of the President of the United States, "Department of Education," *Budget of the United States Government: Fiscal Year 2004* (Washington, D.C.: U.S. Government Printing Office, 2003), http://www.whitehouse.gov/news/usbudget/fy2004/education.html (downloaded June 11, 2003).

Protection and IRS Accountability Act of 2003—the most recent tax bill that contains several other confidentiality and disclosure provisions.[12] Moreover, as of June 2003, Congress had not acted on the proposed amendment.

Apart from the proposed legislative amendment, Education officials noted that several operational details remain to be addressed by IRS and Education, many of which depend ultimately on the final language in the legislation. For example, because the schools act as agents for Education in the review, collection, and disbursement of financial aid awards, the details surrounding how best to make the matching program work for both the schools and the applicants must be addressed. In addition, Education officials said careful consideration must be given to the timing for matching student aid applications with tax returns. According to the officials, most students can submit their FAFSAs starting January 1. The applications provide details on their income, or that of their parents', for the previous year. However, taxpayers have until April 15 to file their tax returns and can request extensions. Therefore, IRS information may not be available for matching purposes until well after initial student aid eligibility determinations have been made. In a September 2000 report, we noted that while such a match may not be timely enough for initial eligibility verification purposes, it may be possible to conduct a match with IRS using fairly complete taxpayer data because financial aid payments are typically not made until late August or September.[13]

Education officials contend that while the timing of the match would be less than ideal for helping to make initial student financial aid decisions, they have established interim steps to address the timing issue, such as multiple disbursement periods and withholding of payments until income verification is completed. Even with these interim steps in place, they acknowledge that the timing of the matching program still remains a challenge. Education officials said they are also in the process of identifying other ways to address all operational details, and are committed to working with IRS to make the matching program a success.

[12]H.R. 1528, The Taxpayer Protection and IRS Accountability Act of 2003, April 1, 2003.

[13]U.S. General Accounting Office, *Benefit and Loan Programs: Improved Data Sharing Could Enhance Program Integrity*, GAO/HEHS-00-119 (Washington, D.C.: Sept. 13, 2000).

Increased Data Sharing Can Improve Student Financial Aid Decisions

Increased data sharing and verification between IRS and Education could result in better decision making when awarding student financial aid and reduced fraud. Both Education's Office of the Inspector General (OIG) and we have reported that increased data sharing can improve Education's student financial aid decisions. Additionally, Education is currently conducting a project that supports the need for increased data sharing.

In a September 2000 report, we recommended that Congress consider amending IRC Section 6103 to improve the ability of certain federally funded benefit and loan programs to obtain and share information to make timely and accurate eligibility determinations, while protecting personal privacy and the confidentiality of personal information.[14] Specifically, we said "the Congress should consider amending Section 6103(l) of the Internal Revenue Code to authorize IRS to disclose certain taxpayer data to officers, employees, and contractors or other agents (such as schools) of Education for purposes of verifying information reported on applications for financial aid." Additionally, our recent January 2003 Performance and Accountability Series report indicates that Education could benefit from receiving IRS taxpayer information to verify income information reported on student aid applications.[15]

According to Education's OIG, some students report inaccurate information either through error or fraud on their federal student aid applications through, for example, underreporting of income. In a statement before Congress in 2000, the Education's Inspector General stated that underreporting of income by student aid applicants costs federal taxpayers over $100 million annually in overawards of Pell Grants and awards to ineligible persons. In addition to underreporting, Education's OIG found numerous examples of fraud, as shown in table 1. Applicants' ability to receive student aid fraudulently could be reduced if Education could verify applicant information using IRS taxpayer data.

[14]GAO/HEHS-00-119.

[15]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Education*, GAO-03-99 (Washington, D.C.: January 2003).

Table 1: Selected Examples of Federal Student Aid Fraud Identified by Education's OIG

Date	Program	Description of fraud
1993-96	Pell Grant	Falsification of student eligibility documents (including false IRS documents) that made ineligible students appear eligible. Received in excess of $250,000 in Pell Grant funds.
1994-2000	Pell Grant	Eight admissions representatives charged with three multicount criminal indictments for procuring students to falsify financial information to qualify for Pell Grant funds.
1998	Federal student aid	Financial aid consultant lowered clients' incomes on FAFSA and tax forms to increase students' chances of receiving financial aid.
1999	Pell Grant	Scheme involving program fraud, false statements, and tax fraud in connection with postsecondary programs the defendants falsely claimed to be administering.
2001	Federal grants, work-study, and loans	Twenty-six people charged in 23 separate criminal cases with fraudulently obtaining over $2.6 million in federal grants, work-study, and loans.
2003	Pell Grant	Defendant found guilty of embezzling $600,000 of Pell Grant funds through false ownership tactics.

Source: Office of Inspector General, Department of Education.

In addition to these examples of fraud, Education's research indicates it may have overpaid an estimated $602 million in Pell Grants over a 2-year period. As part of its efforts to show the effect of IRC Section 6103 restrictions on eligibility and payment decisions, Education is conducting the Pell Grant Payment Study by matching information provided on student aid applications with IRS taxpayer information. The study began in 1999 and measures the extent of underreporting and overreporting of income based on student aid applicants' characteristics, such as income, tax filing status, and recipients' schools.

To enable this match, Education provides IRS with a file of student aid applicants' SSNs. IRS officials match these SSNs with taxpayer income information and provide the aggregated results to Education. This format protects the taxpayers' confidentiality, in accordance with IRC Section 6103, which prohibits IRS from revealing the identity of these taxpayers to Education. Since Education does not know the identity of the taxpayers, it can estimate the amount of overpayments but cannot associate a specific

overpayment with a particular individual and cannot ascertain when a mismatch may be legitimate. Thus far, the study has estimated the percentage of Pell Grant overpayments to be 3.4 percent, or $272 million dollars, in fiscal year 2001 and 3.3 percent, or $330 million dollars, in fiscal year 2002, for a total of $602 million. Education has not done a similar study for its loan programs, which account for approximately 80 percent of federal student aid funds.

Education officials believe amending IRC Section 6103 to enable Education to match student aid applicant information with several elements of federal income tax return information "would substantially reduce the risk of fraud and overpayments" associated with Education's student financial aid program, would eliminate the need for taxpayer consent in conjunction with the ICR program, and would make the program more administratively efficient. This, in turn, would enhance the integrity of the federal student aid programs and ensure that students are receiving the amounts of assistance for which they are eligible.

IRS Does Not Use Education's Student Aid Data and the Potential Benefit of Doing So Appears to Be Limited

IRS does not use personal information from applicants that Education collects and maintains to ensure that taxpayers meet their tax obligations because IRS officials believe the taxpayer information IRS receives is more accurate. In general, IRS officials' views are supported by its past estimates of taxpayers' levels of compliance and by the results of Education studies and investigations.

IRS officials cite a number of reasons for not using information Education collects and maintains to ensure that taxpayers meet their tax obligations. IRS officials said they believe the taxpayer information IRS collects and maintains on over 100 million individual taxpayers, who file income tax returns annually, is more accurate than that collected and maintained by Education from applicants applying for federal student aid. The officials noted that because federal student aid is based on income, applicants seeking financial aid might be inclined to underreport their income to Education in hopes of securing larger aid awards. The officials said they believe most taxpayers know that failure to fully disclose income to IRS could result in an audit or the use of IRS enforcement authorities to collect

delinquent taxes.[16] Further, the officials also said they believe the requirement to file a tax return annually helps to ensure that some of the information IRS maintains, such as taxpayers' addresses, is more current when compared to similar information maintained by Education.

IRS routinely relies on information from third-party sources (e.g., banks) to ensure that taxpayers meet their tax obligations, including both whether taxpayers correctly report information necessary to determine the taxes due, if any, and whether any taxpayers who should have filed returns did not. Through its document matching programs, IRS uses these third-party documents to verify what taxpayers report on their tax returns.[17] Similarly, IRS identifies individuals who did not file tax returns if it receives third-party documents for these individuals.

Past IRS estimates of taxpayers' compliance have indicated that taxpayers whose incomes are subject to document matching are among the most compliant. For example, in the mid-1990s, IRS estimated that taxpayers with only wage income had a 99 percent voluntary reporting compliance rate, and taxpayers with interest and dividend income were 95 percent compliant in reporting this income. IRS is currently conducting a study that is intended to update these compliance estimates.

However, although document matching programs work well for taxpayers whose incomes are subject to third-party reporting to IRS, they do not help when taxpayers have sources of income that are not subject to such reporting. Both the Treasury Inspector General for Tax Administration and we have previously reported that taxpayers whose incomes are not subject to information reporting, like those who are self-employed, are much less

[16]In general, if taxes remain unpaid after IRS gives appropriate notice and demand for payment, IRS is authorized by the IRC to use its enforcement authority in the form of a levy, seizure, or lien. The levy of assets such as bank accounts and wages that are in the possession of third parties, such as banks and employers, is referred to as a levy, and the levy of assets in the possession of the taxpayer is referred to as a seizure. A lien is a legal claim that attaches to property to secure the payment of a debt. The filing of a lien would prevent the taxpayer from selling an asset, with clear title, without payment of the tax debt.

[17]IRS's Automated Underreporter Program is designed to identify wage earners who do not report all of their income on their tax returns. The program compares the income reported on their tax returns to the income reported by employers and other third-party sources on Forms W-2 and 1099.

compliant in fulfilling their tax obligations than those whose incomes are subject to such reporting.[18]

However, the data collected and maintained by Education are not suited to helping IRS identify taxpayers who are not covered by existing document matching programs. The student aid applications ask students and/or their parents to report income information directly from their tax returns and generally do not ask for other corroboration of income.

IRS officials' view that IRS data are likely to be more accurate than Education's data is also supported by Education's studies. As noted earlier, Education's Pell Grant Payment Study results have found that some student aid applicants have underreported income on their applications compared to the income that they reported to IRS. Although Education estimates some underpayments to students during these studies, officials say that these, in their judgment, appear to result from mistakes in filling out applications. The work of the Education OIG also suggests that a significant number of student aid applicants falsify copies of tax returns or other information that they submit to Education to show lower incomes and thereby claim higher amounts of student aid.

Given that Education data may have limited utility for tax administration, IRS has not investigated use of the data for tax administration. If Congress does authorize Education to obtain taxpayer information to verify students' eligibility for financial aid, the resulting database of mismatches between data reported to each institution may represent a ready and low-cost opportunity for IRS to investigate whether there is any reasonable potential for using Education information for tax administration purposes. The database mismatches would identify how many, if any, student aid applicants reported less income to IRS than to Education and the number of cases in which the applicants may not have filed tax returns at all.

Concluding Observations

Education obtains some information from IRS to use in administering its programs but is unable to obtain information that could help it reduce financial aid overpayments that it estimated to total $602 million in fiscal

[18]U.S. General Accounting Office, *Reducing the Tax Gap: Results of a GAO-Sponsored Symposium*, GAO/GGD-95-157 (Washington, D.C.: June 2, 1995), and Treasury Inspector General for Tax Administration, *Management Advisory Report: Comparing the Internal Revenue Service's Verification of Income for Wage Earners and Business Taxpayers*, Reference No: 2001-30-166 (Washington, D.C.: September 2001).

years 2001 and 2002. As government agencies continue to seek efficient ways to improve federal benefit and loan program decisions by reducing fraud and error, data sharing has been a valuable tool for supporting integrity in federal programs. However, the need to verify self-reported information must be balanced with privacy concerns. Existing disclosure laws help ensure that federal agencies properly handle the personal information they collect. Modifying the legal constraints in IRC Section 6103 for sharing taxpayer information—with accompanying requirements to ensure that the data are used only for authorized purposes—is one way to address student aid program vulnerabilities while retaining protections for personal privacy. We have previously recommended that Congress consider such a change.

IRS does not use student aid application data because IRS officials believe that the data IRS receives are more accurate than student aid application data. This belief is supported by IRS data and by Education studies, and thus there appears to be little benefit to attempting to use the Education data for tax administration purposes.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Commissioner of Internal Revenue and the Secretary of Education. On July 15, 2003, the Commissioner of Internal Revenue and the Chief Operating Officer of Education's Office of Federal Student Aid each provided written comments on a draft of this report. (See apps II and III, respectively.) Officials representing the Office of Federal Student Aid also provided technical comments to clarify specific sections of the draft report. We have incorporated these comments into the report where appropriate.

The IRS Commissioner and Education officials raised no concerns. In his comments, the Commissioner noted that although we did not make any recommendations, the report provides an accurate and comprehensive review of the issue, and will be a good source document for policymakers as they address increased sharing of taxpayer information. Additionally, the Chief Operating Officer acknowledged the potential for saving hundreds of millions of dollars annually in overpayments and other benefits through an effective data matching program with IRS, and said that Education officials would continue to support necessary legislative changes.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its date. At that time we will send copies to the Chairman and Ranking Minority Member, House Committee on Ways and Means; the Chairman and Ranking Minority Member, Subcommittee on Oversight, House Committee on Ways and Means; the Secretary of Education; the Secretary of the Treasury; and the Commissioner of Internal Revenue. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact me at (202) 512-9110 or on brostekm@gao.gov, or Signora May at (404) 679-1920 or on maysj1@gao.gov. Other staff who made key contributions to this report were Michelle Bowsky, Michele Fejfar, Jyoti Gupta, Shirley Jones, Anne Laffoon, and Miltresa McMichael.

Michael Brostek
Director, Tax Issues

Appendix I: Objectives, Scope, and Methodology

To respond to your request, we performed our work at various Internal Revenue Service (IRS) offices, including the Office of Governmental Liaison; the Office of Safeguards; the Office of Program, Evaluation, and Risk Analysis; and the Privacy Advocate's Office. Our work also included interviews with employees in IRS's Wage and Investment Operating Division and IRS's Small Business/Self Employed Operating Division, the Department of the Treasury's Office of Tax Policy and the Office of the Treasury Inspector General for Tax Administration, and program offices at the Department of Education. We collected and analyzed information on data sharing and matching between IRS and Education during fiscal years 2000 through 2002.

To determine whether Education uses IRS taxpayer information to verify information provided by applicants for federal student aid and the benefits of increasing verification activities, we analyzed the student financial aid application and determined what personal information Education collects from applicants. We interviewed Education officials as well as IRS officials to obtain data on the type of taxpayer information received from IRS, including how, when, and for what purpose the information is received. We identified the legislative and regulatory authorities that govern IRS's disclosure of taxpayer information to Education.

Additionally, we determined how Education is using the information received from applicants and IRS, and whether it is matching/cross-checking the information to improve eligibility determinations. To determine the benefits of increasing verification activities, we collected and analyzed data to assess how increased disclosure of information would affect taxpayer confidentiality and privacy interests. We interviewed IRS and Education officials to obtain views on possible impediments or missed opportunities to match/cross-check information to make better programmatic decisions, and we reviewed existing studies or reports on data matching/cross-checking activities. We determined what personal information Education collects but does not match/cross-check with IRS and why not, and whether officials believed matching/cross-checking would be useful for eligibility determinations.

To determine whether IRS uses personal information maintained by Education to ensure that taxpayers meet their tax obligations and the benefits of increasing such activities, we collected data to determine what personal information IRS obtains from Education. We interviewed IRS and Education officials to obtain data on the type of personal information that is received from Education, including how, when, and for what purpose the information is received. We identified the legislative and regulatory

authorities that govern Education's disclosure of personal information to IRS.

Additionally, we assessed how IRS is using the information received from Education, and whether it is matching/cross-checking the information to better ensure taxpayers are meeting their tax obligations. To determine the benefits of increasing verification activities, we collected and analyzed data to determine what personal information IRS receives from Education but does not match/cross-check and why not, and whether officials believe the information would be useful for tax administration. We determined what personal information IRS does not receive from Education, whether IRS is aware of the information, and whether IRS officials believe receiving it would be useful for tax administration.

As used in this report, "data sharing" means obtaining and disclosing information on individuals between Education and the IRS to determine eligibility for student financial aid and to ensure that taxpayers have met their obligations. Education's use of taxpayer information to verify information obtained from applicants refers to the matching or cross-checking procedures that are conducted, and is covered by interagency computer matching agreements between IRS and Education.

Our review was subject to some limitations. We did not assess the reliability or quality of taxpayer and other personal information that is shared and verified between Education and IRS. We relied on officials to identify those IRS offices that use personal information because there is no central, coordinating point within IRS for receipt of this type of information. Additionally, we relied on IRS and Education officials' views on possible impediments or missed opportunities to match/cross-check information, any additional data sharing and verification needs, and the benefits and challenges of increased disclosure of taxpayer information.

We conducted our work from August 2002 through June 2003 in accordance with generally accepted government auditing standards.

Appendix II: Comments from the Internal Revenue Service

COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

July 15, 2003

Mr. Michael Brostek
Director, Tax Issues
United States General Accounting Office
Washington, DC 20548

Dear Mr. Brostek:

I have completed a review of the General Accounting Office (GAO) draft report titled, "*Taxpayer Information: Increased Sharing and Verifying of Information Could Improve Education's Student Aid Award Decisions*" (GAO-03-821, June 2003). The intent of the study was to determine whether:

1) The Department of Education (Education) uses taxpayer information to verify information provided by applicants for federal student financial aid and the benefits.
2) The IRS uses personal information maintained by Education to ensure that taxpayers meet their tax obligations and the benefits.

You determined that Education would benefit by receiving additional information from us; however, Internal Revenue Code Section 6103 would need to be modified to allow us to share additional information. As always, if the Congress chooses to amend the federal disclosure statue, we will implement it accordingly.

We agree that obtaining data from Education's student aid application would not benefit us because the information on the application is based on the tax return already in our possession.

In summary, although you did not make any recommendations for the IRS, your report provides an accurate and comprehensive review of this issue. It will be a good source document for policy-makers as they address the sharing of taxpayer information. If you have any questions, please contact David R. Williams, Chief Communications and Liaison at (202) 622-5440.

Sincerely,

/For Mark W. Everson

Mark W. Everson

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Appendix III: Comments from the Department of Education

CHIEF OPERATING OFFICER

July 15, 2003

Mr. Michael Brostek
Director, Tax Issues
Government Accounting Office
Washington, D.C. 20548

Dear Mr. Brostek:

Thank you for the opportunity to respond to your draft audit report entitled, *"Taxpayer Information: Increased Sharing and Verifying of Information Could Improve Education's Student Aid Award Decisions" (GAO-03-821).* I am responding on behalf of the Department.

The Title IV, Higher Education Act (HEA), programs play an important part in assisting millions of Americans each year in attaining their higher education goals. Ensuring the integrity of these programs – getting the right amount of funds to eligible students at the right time – is a critical and primary goal of the Department.

As stated in your draft report, an effective data match of taxpayer information with the Internal Revenue Service has the potential to save hundreds of millions of dollars in overpayments each year. In addition, it would assist in reducing the amount of student aid received as a result of fraud.

Even though we estimate that the amount of overpayments in the Federal Pell Grant program is only a small percent of the disbursements, it still translates to well over $300 million each year. We are anxious to significantly reduce this amount and we continue to work with our counterparts in the Department of Treasury and the Office of Management and Budget to support the necessary legislative changes to do this.

Again, thank you for the opportunity to comment on the draft report.

Sincerely,

Theresa S. Shaw

830 First Street, NE, Washington, D.C. 20202
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